

1 **REBUTTAL TESTIMONY OF**

2 **JAMES E. SWAN, IV**

3 **ON BEHALF OF**

4 **SOUTH CAROLINA ELECTRIC & GAS COMPANY**

5 **DOCKET NO. 2012-218-E**

6  
7 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND**  
8 **POSITION.**

9 A. My name is James E. Swan, IV. My business address is 220  
10 Operation Way, Cayce, South Carolina. I am employed by SCANA  
11 Services, Inc. and serve as the Controller of SCANA Corporation and its  
12 subsidiaries ("SCANA"), including South Carolina Electric & Gas  
13 Company (the "Company" or "SCE&G").

14 **Q. HAVE YOU PREVIOUSLY SUBMITTED DIRECT TESTIMONY IN**  
15 **THIS PROCEEDING?**

16 A. I have.

17 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

18 A. The purpose of my rebuttal testimony is to respond to issues raised  
19 by (i) Ralph C. Smith, witness for AARP, related to federal income tax  
20 expense, particularly regarding the treatment of the Section 199 Domestic  
21 Production Activities Deduction ("DPAD"), and (ii) Kevin O'Donnell,

1 witness for the South Carolina Energy Users Committee (“SCEUC”),  
2 related to rate base treatment of deferred pension costs.

3

4 **TREATMENT OF THE SECTION 199 DOMESTIC PRODUCTION**  
5 **ACTIVITIES DEDUCTION**

6

7 **Q PLEASE EXPLAIN THE DPAD.**

8 A. Under the American Jobs Creation Act of 2004, and as an incentive  
9 to increase the level of manufacturing activity in the United States, the  
10 federal income tax code was amended to provide for a specific deduction to  
11 be taken against income earned from qualifying domestic production  
12 activities, as defined. Qualifying domestic production activities include the  
13 manufacture of tangible personal property; the production of computer  
14 software, sound recordings and certain films; the production of electricity,  
15 natural gas, or water; and construction, engineering, and architectural  
16 services. Generally, although subject to certain limitations, companies that  
17 earn higher levels of taxable income from qualifying activities qualify for  
18 higher computed deductions. The DPAD was three percent of income  
19 earned from qualifying production activities for tax years 2005 and 2006;  
20 six percent for tax years 2007 through 2009; and nine percent for tax years  
21 2010 and 2011. Since SCE&G is not solely a manufacturing company, the  
22 computation of the taxable income from qualifying production activities is

1 quite complex, and estimates of the DPAD to be recognized are  
2 incorporated into the Company's income tax accruals in the normal course  
3 of its business. Then, when the computations are finalized as part of the  
4 preparation of the actual income tax returns, adjustments are recorded as  
5 necessary.

6 **Q. DO YOU AGREE WITH MR. SMITH'S PROPOSED ADJUSTMENT**  
7 **REGARDING THE TREATMENT OF THE DPAD FOR**  
8 **RATEMAKING?**

9 A. No, I do not.

10 **Q. PLEASE EXPLAIN.**

11 A. The Public Service Commission of South Carolina ("Commission")  
12 has traditionally accepted the use of "regulatory per books" income tax  
13 amounts for ratemaking with only limited use of pro forma adjustments,  
14 such as those designed to capture the tax effects of other pro forma and  
15 accounting adjustments—as was presented in the Company's Application  
16 in this case. This long-standing practice is consistent with the use of a  
17 historical test year, with only certain known and measurable changes being  
18 applied via accounting and pro forma adjustments. Thoughtful  
19 consideration of the ramifications of Mr. Smith's proposed federal income  
20 tax adjustment reflects both the wisdom of this long-standing practice and  
21 the problems with departing from it.

1 Q. DOES THE REGULATORY PER BOOKS FEDERAL INCOME TAX  
2 AMOUNT CALCULATED BY THE COMPANY FOR THE TEST  
3 YEAR INCLUDE AN AMOUNT FOR THE DPAD?

4 A. Yes. The 2011 regulatory per books federal income tax figure  
5 reflects an estimated 2011 DPAD of \$9.844 million. However, it also must  
6 be noted that the 2011 regulatory per books federal income tax figure  
7 reflects a (favorable) true-up to the 2010 DPAD that had been previously  
8 estimated in the normal course of closing the books for 2010. That 2010  
9 DPAD true-up figure, recorded in 2011, is \$8.218 million (or \$2.876  
10 million of federal income tax expense reduction). The 2010 DPAD totaled  
11 \$15.256 million as per the Company's response to AARP Data Request 1-  
12 76; the 2010 DPAD reflected in the Company's 2010 financial statements  
13 was \$7.038 million as reflected on page 261 of the Company's 2010 FERC  
14 Form 1 filing provided in the Company's response to AARP Data Request  
15 1-77. The difference of \$8.218 million is reflected within 2011's  
16 regulatory per books federal income taxes.

17 Q. DOES MR. SMITH'S CALCULATION CORRECTLY CONSIDER  
18 THE DPAD AMOUNTS REFLECTED IN THE 2011 REGULATORY  
19 PER BOOKS FEDERAL INCOME TAX AMOUNTS?

20 A. No, it does not. If the amount for DPAD within federal income  
21 taxes were to be adjusted as Mr. Smith proposes, then the amount of the  
22 adjustment should be determined based not on a comparison of the \$19.517

1 million figure to the \$9.844 million figure as Mr. Smith has done, but on a  
2 comparison of that amount to the sum of \$9.844 million and \$8.218  
3 million. This comparison would result in a much smaller pro forma  
4 adjustment for DPAD of \$1.455 million, or \$ .509 million of total federal  
5 income taxes (or \$ .488 million for retail electric). Thus, the calculation of  
6 Mr. Smith's proposed adjustment to lower income taxes is overstated  
7 because he does not consider both amounts.

8 **Q. ARE THERE OTHER CONCERNS WITH MR. SMITH'S**  
9 **PROPOSED DPAD CALCULATION?**

10 A. Yes. Fundamentally, Mr. Smith's \$19.517 million DPAD figure is  
11 not appropriate because it is a hypothetical number. It is based on the  
12 assumption that there is no limitation on the DPAD to be claimed by the  
13 Company, when in fact a limitation did indeed apply. By using this figure,  
14 Mr. Smith speculates that no such limitations will apply in the future and,  
15 as such, he clearly departs from amounts which are both known and  
16 measurable. If instead Mr. Smith were to have selected the DPAD figure  
17 reflective of a limitation, even on a stand-alone basis, he might have  
18 selected a figure of \$16.244 million as the appropriate DPAD amount.  
19 Comparing that amount to the sum of \$9.844 million and \$8.218 million as  
20 I discussed above would have resulted in the proposal of an adjustment to  
21 increase, rather than decrease, federal income taxes.

1 In this context, I also note that there is uncertainty as to whether the  
2 DPAD will be available upon the implementation of any significant federal  
3 income tax reform in the near future. While this should be irrelevant when  
4 basing rate recovery on a historical test year, it points to the dangers of  
5 accepting Mr. Smith's hypothetical figure above. That is to say, Mr.  
6 Smith's proposal, which hinges upon use of a hypothetical number as a  
7 basis for reducing actual rate recovery, significantly departs from the  
8 known and measurable principle heretofore applied in determining the  
9 appropriate rates to be used by the Company. Given the uncertainty  
10 surrounding the continued availability of the DPAD, the use of "zero" as a  
11 DPAD figure might also be a reasonable prediction, since that may well be  
12 what is experienced by SCE&G while any new rates are in effect. In  
13 isolation, that assumption would have significantly increased the rate  
14 request in the Application.

15 **Q. DO YOU BELIEVE THAT ESTIMATING THE DPAD FOR THE**  
16 **TEST YEAR USING EITHER MR. SMITH'S PREDICTION OR A**  
17 **PREDICTION OF ZERO WOULD BE APPROPRIATE?**

18 A. No. In my opinion, neither Mr. Smith's prediction nor a prediction  
19 of "zero" is an appropriate basis for a pro forma adjustment in this  
20 proceeding. Rather, consideration of the regulatory per books federal  
21 income tax figure, as has historically been accepted by the Commission and  
22 as applied by the Company in its Application, is the appropriate

1 methodology for use with respect to the DPAD. Therefore, Mr. Smith's  
2 proposed adjustment should not be accepted by the Commission.

3 **Q. ARE THERE ADDITIONAL CONCERNS WITH MR. SMITH'S**  
4 **ANALYSIS AND RECOMMENDATION?**

5 A. Yes. Specifically, there are two other aspects of Mr. Smith's  
6 proposed adjustment that I would also like to address: adjusting rate base  
7 and removing the impact of all 2010 federal income tax true-ups.

8 **Q. PLEASE EXPLAIN WHY AN ADJUSTMENT TO RATE BASE**  
9 **WOULD BE APPROPRIATE WITH RESPECT TO THE DPAD.**

10 A. The 2011 DPAD figure of \$9.844 million which is included in the  
11 total amount of regulatory per books federal income taxes is an estimate  
12 based on the presumed election of bonus depreciation for all asset classes.  
13 This reasonable premise was developed, and the resulting estimate was  
14 recorded in the Company's books, at the end of 2011 – many months prior  
15 to the actual filing of the 2011 income tax return when the elections were  
16 perfected. Notably, deferred income tax liabilities as of December 31,  
17 2011, as reflected in the Application, also reflected that same premise – as  
18 consistency requires. In other words, deferred tax liabilities were increased  
19 by the effect of bonus tax depreciation expected to be claimed for 2011 and,  
20 importantly, rate base in the Application was necessarily reduced by the  
21 same amount.

1 **Q. DOES MR. SMITH'S CALCULATION PROPERLY CONSIDER**  
2 **RATE BASE ADJUSTMENTS FOR BONUS DEPRECIATION?**

3 A. No, it does not. If Mr. Smith's proposal that federal income tax  
4 expense should reflect DPAD actually claimed on the 2011 tax return were  
5 accepted, then a related rate base adjustment to eliminate the effect of the  
6 bonus depreciation which was not ultimately elected (or approximately \$27  
7 million) would also be appropriate. This increase in rate base would in turn  
8 increase the revenue requirement by approximately \$3.3 million. As such,  
9 this adjustment alone would almost fully offset the adjustment proposed by  
10 Mr. Smith, and along with other adjustments, would put additional upward  
11 pressure on the revenue requirement for the Company.

12 **Q. DOES MR. SMITH PROPERLY CONSIDER THE EFFECTS OF**  
13 **ALL 2010 FEDERAL INCOME TAX TRUE-UPS?**

14 A. No, he does not. Specifically, a proper extension of the logic behind  
15 Mr. Smith's proposed adjustment would require removing the effects of  
16 prior estimation from the regulatory per books federal income tax figure.  
17 To accomplish this, an even further adjustment would be required to  
18 remove other amounts reflected in the regulatory per books federal income  
19 tax figure which relate to true-ups to the prior (2010) income tax accruals  
20 which were recorded in the normal course of 2011 (when the 2010 tax  
21 return was eventually completed and filed). The largest among these items  
22 is the true-up of the 2010 DPAD discussed above, but there are others, as



1 well. Removing all effects of 2010 from the 2011 regulatory per books  
2 federal income tax figure would result in a further increase in federal  
3 income tax expense.

4 **Q. HAVE YOU PREPARED A FINANCIAL EVALUATION OF THE**  
5 **VARIOUS CONCERNS WITH MR. SMITH'S PROPOSAL?**

6 A. Yes. I have included as Rebuttal Exhibit No. \_\_ (JES-1) to this  
7 testimony an analysis depicting several paths that pro forma adjustments to  
8 the Application could have taken based on Mr. Smith's theory, including  
9 those described above, with varying results and impacts on the retail  
10 revenue requirement. The schedule serves to point out the uncertainties  
11 inherent in Mr. Smith's proposed approach and the wisdom of the  
12 Commission's prior practice of incorporating actual historical results into  
13 its ratemaking in this area. Mr. Smith's proposal would operate as an  
14 avenue for the introduction of speculative pro forma and accounting  
15 adjustments.

16 **Q. DO YOU BELIEVE THAT MR. SMITH'S PROPOSAL**  
17 **REGARDING THE TREATMENT OF DPAD FOR RATEMAKING**  
18 **SHOULD BE ADOPTED BY THE COMMISSION?**

19 A. No, I do not. The acceptance of Mr. Smith's proposed adjustment  
20 without modification and/or the addition of other related adjustments would  
21 be inappropriate. In addition to the concerns and observations that I  
22 address above, those modifications or additional entries would, in the

1 aggregate, result in an Application which reflects a higher federal income  
2 tax expense figure and a higher rate base than those reflected in the original  
3 Application. I therefore do not support Mr. Smith's proposed pro forma  
4 adjustment and I urge the Commission not to adopt his recommendation.

5

6 **RATE BASE TREATMENT OF DEFERRED PENSION COSTS**

7

8 **Q. DO YOU AGREE WITH MR. O'DONNELL'S STATEMENT THAT**  
9 **THE COMPANY'S DEFINED BENEFIT PENSION PLAN IS FULLY**  
10 **FUNDED?**

11 A. No, I do not.

12 **Q. PLEASE EXPLAIN.**

13 A. As noted in its Form 10-K, SCANA's pension plan is adequately  
14 funded under current (funding) regulations. Mr. O'Donnell correctly quotes  
15 this language, but then incorrectly states that the pension plan is fully  
16 funded.

17 As shown in SCANA'S pension disclosures in its Form 10-K filed  
18 with the Securities and Exchange Commission ("SEC") for the year ended  
19 December 31, 2011 (the "Test Period") (pages 77 through 82), the fair  
20 value of the plan's assets totaled \$755 million (p.78), while the benefit  
21 obligation under the plan was \$830 million (p.77), such that the plan  
22 actually carried a book liability of \$75 million as of the end of the Test

1       Period.<sup>1</sup> So, while it is true that the plan is adequately funded under the  
2       requirements of the United States Department of Labor (“DOL”), it is  
3       incorrect to state that the plan is fully funded.

4               Regardless, the status of SCANA’s pension plan funding and the  
5       related disclosures surrounding this funding level are independent of the  
6       issue of whether SCE&G’s \$33 million of deferred pension cost may be  
7       included in rate base. The Company has foregone the collection of this  
8       particular pension cost because of the specific deferral authorized by this  
9       Commission and, as a result, has been required to use its capital to offset  
10      the amounts that otherwise would have been received through collection of  
11      the cost in current rates.

12   **Q.   PLEASE RESPOND TO MR. O’DONNELL’S RECOMMENDATION**  
13       **THAT THE COMMISSION DISALLOW THE COMPANY’S**  
14       **REQUEST TO PLACE ITS \$33 MILLION (NET-OF-TAX)**  
15       **DEFERRED PENSION COSTS INTO RATE BASE.**

16   A.       I disagree with Mr. O’Donnell’s recommendation that deferred  
17       pension costs be excluded from rate base. In order to foster cross-  
18       generational equity, this Commission and others have traditionally allowed  
19       full accrual based pension costs (computed under generally accepted

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<sup>1</sup>       These amounts reflect consolidated balances for SCANA and its subsidiary corporations, including SCE&G. Comparable amounts for SCE&G alone are reported in the Form 10-K and also in Exhibit C-1 to the Company’s Application in this proceeding, as follows: the fair value of plan assets is \$695 million and the benefit obligation is \$705 million, resulting in a book liability of \$10 million.

1 accounting principles) to be considered in ratemaking, regardless of the  
2 timing of the funding of specific contributions to those plans. As this  
3 Commission recognized in Order Nos. 2003-38 and 2005-2, the return on  
4 the Company's pension plan assets in some prior years exceeded the cost of  
5 accruing pension benefits for employees, resulting in income that offset  
6 certain of the Company's pension expense accrual requirements. However,  
7 as a result of the credit market dislocation and related equity market turmoil  
8 of 2008 and 2009, and the ensuing amortization of some of the plan's  
9 investment losses, the Company has been required to accrue additional  
10 pension expense in order to properly reflect the Company's obligations to  
11 provide the pension benefits for its employees. In the immediate aftermath  
12 of the 2008-2009 market losses, the Company deferred these costs rather  
13 than collecting them from customers.

14 **Q. HAS THE COMPANY DEFERRED THESE PENSION COSTS**  
15 **WITH THE APPROVAL OF THE COMMISSION?**

16 A. Yes. These costs were deferred under the authority of Commission  
17 Order Nos. 2009-81 and 2010-471. Based on traditional ratemaking  
18 principles applied by this Commission, these deferred pension costs  
19 otherwise would have been appropriately collected from the Company's  
20 customers via the inclusion in customer rates of (full) accrued pension costs  
21 determined under generally accepted accounting principles. The deferred  
22 pension cost figure of \$33 million (net-of-tax) is the result of this delay in

1 the collection of these pension costs which were actually accrued and  
2 incurred but which were not collected through rates for obligations existing  
3 as of the end of the Test Year. Although these costs were accrued and  
4 incurred as a result of obligations incurred under the pension plan, the  
5 Company deferred these costs in this manner as a means to limit the rate  
6 impact to customers in the immediate aftermath of the market turmoil  
7 referred to above. Including this deferred amount in rate base as part of the  
8 current proceeding is entirely appropriate, because these expenses have not  
9 been included in rates previously and have not yet been collected, but do  
10 represent a known and measurable liability incurred by the Company.

11 **Q. PLEASE EXPLAIN HOW THIS DEFERRED PENSION COST**  
12 **FIGURE IS DIFFERENT FROM A PENSION ASSET WHICH**  
13 **MIGHT ALSO BE INCLUDED IN RATE BASE.**

14 A. The plan's net liability position discussed above is primarily the  
15 result of actuarial losses which were incurred following the credit market  
16 dislocation and related equity market turmoil of 2008 and 2009, but which  
17 have yet to be amortized as a component of the accrual of pension cost.  
18 The required accounting for those unamortized actuarial losses (the  
19 recording of an obligation and offsetting regulatory asset under the Federal  
20 Energy Regulatory Commission Uniform System of Accounts ("FERC  
21 USoA")), results in the plan's net liability, as disclosed in the SCANA  
22 Form 10-K filed with the SEC and referred to by SCEUC Witness

1 O'Donnell. It is important to note that absent this required accounting, the  
2 plan is in a "pension asset" position. Notwithstanding this position, the  
3 Company is not requesting rate base treatment of this pension asset, which  
4 balance is representative of the significant levels of prior funding of the  
5 plan. Although arguments for including such a pension asset in rate base  
6 are compelling, the Company has never sought to place pension assets into  
7 rate base even though other commissions have recognized such amounts for  
8 other utilities.

9 **Q. IS THE COMPANY SEEKING RATE BASE TREATMENT OF THE**  
10 **REGULATORY ASSET FOR UNAMORTIZED ACTUARIAL**  
11 **LOSSES REFERRED TO ABOVE?**

12 A. No. The Company is not seeking rate base treatment of the above-  
13 mentioned unamortized actuarial losses reflected as regulatory assets under  
14 the FERC USoA. To do that would require an equal and offsetting rate  
15 base reduction for the related portion of the net benefit obligation recorded,  
16 which would result in no net change to rate base.

17 To be very clear, in its Application, the Company is only seeking  
18 rate base inclusion of the costs which have been specifically deferred for  
19 future collection under the prior Commission orders. It is not seeking rate  
20 base treatment for any other pension asset figure reflected on its books.

1   **Q.   DID ORS MAKE A RECOMMENDATION REGARDING**  
2   **RECOVERY OF THE DEFERRED PENSION EXPENSE?**

3   A.           Yes. ORS Witness Ford recommends accepting the Company's  
4           proposal to amortize the deferred pension expense as part of base rates, but  
5           recommends an amortization period of 30 years instead of the 12-year  
6           period requested by the Company in its Application.

7   **Q.   WHAT IS THE COMPANY'S POSITION REGARDING ORS'S**  
8   **RECOMMENDATION?**

9   A.           For purposes of this proceeding, the Company accepts ORS's  
10          proposal. This long period of eventual recovery is further supportive of the  
11          inclusion of the balance within rate base.

12   **Q.   DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

13   A.           Yes.

SCE&amp;G

Impact of Federal Income Tax Adjustments on Revenue Requirement

Test Year ended December 31, 2011

	2011 DPAD As reflected in filing	As Proposed by AARP	As Proposed by AARP but with consistent rate base treatment	Considering all DPAD already in test year income taxes	Considering Consolidated limitation (as realized)	Considering Stand alone limitation	Removing Federal 2010 adjustments	Incorporating 2011 (as-filed return)	Assuming no DPAD is Available
Federal Income Tax Expense:									
Section 199 DPAD									
1 2011 estimated at closing of test year (per books)	(9,844)								
2 2011 assuming no limitation applies		(19,517)	(19,517)	(19,517)					
3 2011 actually realized on consolidated basis					(18,311)			(18,311)	
4 2011 on separate company basis						(16,244)	(16,244)		
Federal Income Tax Impact (at 35%)									
5 2011 per books	(3,445)								
6 Indicated amount		(6,831)	(6,831)	(6,831)	(6,409)	(5,685)	(5,685)	(6,409)	
7 Remove 2010 DPAD true-up in 2011				2,876	2,876	2,876	2,876	2,876	
8 Other 2010 true-ups in reflected in 2011							802	802	
9 Other 2011 true-ups in reflected in 2012	-	-	-	-	-	-	-	(1,558)	
10 Total Federal tax effects	(3,445)	(6,831)	(6,831)	(3,955)	(3,533)	(2,809)	(2,007)	(4,289)	
11 Retail Allocation	95.82%	95.82%	95.82%	95.82%	95.82%	95.82%	95.82%	95.82%	
12 Indicated impact (decrease)/increase on revenue requirement	(3,301)	(6,545)	(6,545)	(3,789)	(3,385)	(2,692)	(1,923)	(4,109)	-
13 As reflected in Application	(3,301)	(3,301)	(3,301)	(3,301)	(3,301)	(3,301)	(3,301)	(3,301)	(3,301)
Difference (indicated adjustment)									
14 (decrease) increase in Federal income taxes	-	(3,244)	(3,244)	(488)	(84)	610	1,378	(808)	3,301
Impact on revenue requirement (gross up for taxes - row 14/.6147)									
15 (decrease) increase in revenue requirement		(5,277)	(5,277)	(794)	(136)	992	2,242	(1,314)	5,371
Related Rate Base Adjustment (000s):									
16 Remove presumption of bonus depreciation for 15-year property			26,891	26,891	26,891	26,891	26,891	26,891	
17 Retail portion (95.82%)			25,767	25,767	25,767	25,767	25,767	25,767	
18 Return on rate base (per Exhibit C-7)	8.56%								
19 Debt portion	2.85%								
20 Equity portion	5.71%								
21 Debt portion	2.85%								
22 Equity portion, tax-effected	9.29%								
23			12.14%	12.14%	12.14%	12.14%	12.14%	12.14%	
24 Increase in revenue requirement from rate base adjustment			3,128	3,128	3,128	3,128	3,128	3,128	
25 Total increase (decrease) in revenue requirement from indicated adjustments			(2,149)	2,334	2,992	4,120	5,370	1,814	